

The Impact of the Institutional and Regulatory Environment on Shareholder Voting

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We document that certain features of the institutional and regulatory environment governing shareholder voting can affect the co-location of shares' voting and cash-flow rights. We show that "routine" management proposals, for which brokers can vote shares held in "street name" if investors fail to vote, receive more votes favorable to management than "nonroutine" proposals. Some proposals may pass because of a routine classification. Moreover, negative recommendations from the leading shareholder-voting advisory service are associated with fewer votes cast favorable to management. We also find voting results are related to ownership structure, the use of proxy solicitors, and other firm characteristics.

A characteristic often associated with strong corporate governance is the co-location of shares' voting and cash-flow rights. However, the institutional and regulatory environment in which shareholder voting occurs can dislocate these rights, perhaps affecting voting outcomes. In this paper, we examine the impact on shareholder voting of the so-called "broker vote," which is one feature of the institutional landscape that may dislocate voting rights. State and federal securities laws and the rules of the securities exchanges classify management proposals that are included on proxy ballots as either "routine" or "non-routine." If management proposals are classified as routine, then brokers may vote shares held in "street name" if investors fail to vote their shares; that is, there is a broker vote. However, if management proposals are classified as non-routine, brokers cannot vote street name shares and firms report a "broker non-vote." To the extent that brokers vote shares for which they do not own cash-flow rights, voting and cash-flow rights are dislocated. Managers, thus, may have incentives to craft proposals so they are classified as routine, rather than non-routine to influence voting outcomes.

Other features of the environment may also influence shareholder voting. Institutional investors' reliance on common sources of voting information and proxy analysis may concentrate their votes. We explore the effect of recommendations by the leading shareholder advisory service on voting results. We also examine the relations between shareholder voting and the corporate use of firms that solicit shareholder votes, share ownership structure, and other firm characteristics.

We analyze the impact of these features on shareholder voting and proposal passage for a broad set of proposals of Standard & Poor's Super-Composite 1,500 companies during the 1998 proxy season. The S&P Super-Composite 1,500 includes firms in the S&P 500, S&P MidCap 400,

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and S&P SmallCap 600 Indexes. By focusing on these proposals, we explore the impact on shareholder voting and proposal passage of certain features of firms' institutional and regulatory environment that could not otherwise be studied. We find that in a number of instances, state and federal securities laws and the rules of the securities exchanges that govern the voting of shares held by brokers in street name affected shareholder voting and proposal passage. Routine management proposals received, on average, 8% more votes favorable to management than non-routine proposals and 10.3% higher voting turnout. The passage of as many as 73 routine proposals in 1998 may have been swung because they were classified as routine, rather than non-routine, proposals.

We note that the term "routine" is unfortunate, because it may connote "unimportant." This is not the case. Routine proposals include authorizations of additional common equity and approvals of stock-option plans that increasingly are controversial. For proposals seeking the authorization of additional common equity and whose passage was likely swung by broker votes in 1998, we find the median proposed increase in authorized common exceeded 200% of current shares outstanding. For proposals seeking the adoption or addition of shares to stock-option plans whose passage was likely swung by broker votes, total dilution averaged 19.6%. From the perspective of many shareholders, these proposals could have significantly diluted their voting power and perhaps wealth. Although our ability to directly measure harm to shareholders from broker votes is limited, we find evidence suggesting many of the swung proposals may not have been in investors' interests. Institutional Shareholder Services (ISS), the leading shareholder-voting advisory firm, recommended that shareholders vote against 78.1% of the proposals we estimate to have been swung by broker votes.

The original reason for permitting brokers to vote uninstructed shares held in street name was to ensure companies could meet quorum requirements, generally set at 50% of the eligible votes, for shareholder meetings. Although turnout may once have been an issue, we find that voting turnout for routine management proposals in 1998 averaged between 86.2% and 88.7%, depending on proposal type. If brokers had not been permitted to vote uninstructed shares, we estimate that voting turnout would have been between 71.4% and 83.8%. At these levels, few firms would have required broker votes to meet quorum requirements.

We also document the impact of ISS voting advice on shareholder voting. Notably, we find that ISS recommendations unfavorable to management were associated with 13.6% to 20.6% fewer votes cast in favor of management, depending on proposal type. Voting results also were related to the corporate use of proxy solicitors, share ownership structure, and other firm characteristics, including size and share turnover.

In general, the results highlight important determinants of the balance of power between managers and shareholders in the proxy process. We find that state and federal securities laws and the regulations of the securities exchanges can shift the balance of voting power and exacerbate the dispersion of voting and cash-flow rights. The corollary is that not all votes may have an equal impact on firm governance. Thus, the paper's findings have implications for securities regulators who often base rules regarding shareholder influence on simple proportions of shares outstanding, and for studies of ownership structure and corporate control that model voting power as such.

The paper proceeds as follows. In Section I, we examine the role of shareholders in corporate governance. Section II describes the institutional and regulatory environment in which shareholder voting occurs. Section III discusses factors that may affect shareholder voting. Section IV describes the sample. Section V presents the results of univariate and multivariate analyses. Section VI concludes the paper.

I. Role of Shareholders In Corporate Governance

Past research has shown that the interests of managers can diverge from those of investors. Shareholders may moderate managers' pursuit of their own interests by voting on issues included in proxy statements and by voting on control events (Easterbrook and Fischel, 1983 and Pound, 1991). Shareholders' ability to monitor and affect corporate policy, however, may be restricted. Managers control many of the issues included on ballots, which may undermine shareholder oversight (Berle and Means, 1932). In addition, diffuse corporate ownership, which can create free-rider problems and lower the likelihood that a particular vote is pivotal in an election, may reduce shareholders' incentives to vote, thereby causing them to cede control to managers (Berle and Means, 1932).

Numerous scholars, however, have challenged these views. For example, Easterbrook and Fischel (1983) contend that shareholders have sufficient power as long as they can vote on key events, such as takeovers and proxy contests. They argue that shareholder involvement beyond this point can create inefficiencies, thus imposing transaction costs on firms and mitigating the benefits of delegating corporate decision-making to managers. Easterbrook and Fischel (1991) also argue that shareholders receive a fair deal in expectation: Investors who purchase a firm's initial shares consent to the control contract, and subsequent investors pay for shares in amounts consistent with shares' control rights. However, these arguments ignore the agency costs and losses in corporate wealth that may result if managers override shareholders' preferences. The arguments also overlook the potential impact of changes in firms' institutional and regulatory environment on shares' control rights.

Recent empirical research on voting emphasizes shareholder proposals (e.g., Campbell, Gillan, and Niden, 1999; Carleton, Nelson, and Weisbach, 1998; Gillan and Starks, 2000; Karpoff, Malatesta, and Walkling, 1996). Although this work contributes to our understanding of shareholder activism, it does not inform us of how the institutional and regulatory environment affects shareholder voting and the passage of management proposals.

Empirical research on management proposals centers largely on charter amendments and anti-takeover measures during the mid-1980s and their effect on shareholders' wealth (e.g., Bhagat and Jefferis, 1991; Brickley, Lease, and Smith, 1994; Pound, 1989; Young, Millar, and Glezen, 1993). Companies' governance, voting, and regulatory environments have changed dramatically, however, with the rise of shareholder activism during the 1990s and substantive revisions to the US Securities and Exchange Commission's (SEC's) proxy rules in 1992 and 1998 (Gillan and Starks, 1998). In addition, charter amendments and anti-takeover measure proposals are always classified as non-routine, and so we cannot investigate the impact of proposal classification in these instances.

More recent research on management proposals examines stock-option plan proposals. For example, Morgan and Poulsen (2001) examine the impact on shareholder wealth from stock-option plan proposal announcements between 1992 and 1995. Thomas and Martin (2000) investigate the determinants of shareholder voting for stock-option plan proposals in 1998, focusing on plan characteristics and proposal dilution. Again, this research focuses on a limited set of proposals and does not examine the impact of broker votes on proposal passage.

II. Institutional and Regulatory Environment In Which Shareholder Voting Occurs

Here we describe certain features of the institutional and regulatory environment that may

affect shareholder voting and proposal passage. Subsections A and B discuss several aspects of the proxy voting system, and Subsection C examines vote coordination among institutional investors.

A. Registered- and Beneficial-Owner Voting

Corporate state laws and regulations of the securities exchanges require that publicly held companies allow shareholders to vote on certain company matters. Shareholders generally vote at companies' annual meetings or at special shareholder meetings. Companies send proxy information directly to registered owners; that is, to shareholders who hold shares in their own names. These investors vote shares by returning proxy cards directly to companies or company tabulators.

Other shareholders, known as beneficial owners, hold shares through brokers and banks in street name. Because state laws recognize brokers and banks as the lawful owners of street name shares, brokers, and banks, not beneficial owners, are eligible to vote them. To pass votes through to beneficial owners, companies send proxy materials and ballots for beneficially owned shares to brokers and banks, which then forward the materials and either signed, but unvoted proxy cards or voter instruction forms to beneficial owners. (See Dixon and Thomas, 1998 for more detail.) Beneficial owners cast their votes by completing the proxy cards or by instructing brokers and banks how to vote the shares.

Street-name ownership increased from 20% of domestic issuers' shares traded on the NYSE in 1956 to between 70% and 80% in 1997 (Dixon and Thomas, 1998). The causes of this increase are manifold. Shareholders, including dissidents and institutions that conduct business with issuers, increasingly prefer to hold shares in street names to protect the confidentiality of their identities, securities positions, and votes. At the same time, the brokerage community, which has less time to clear and settle securities transactions now than in the past, has incentives to encourage shareholders to hold securities in street names. To do so and to cover the expense of issuing stock certificates, brokers routinely charge investors fees if they fail to hold shares in street name. For these reasons, activist investors, pension fund managers, financial institutions, and frequent traders are likely to hold securities in street name. The result is that street-name and registered ownership varies across firms depending on investor base.

B. Routine and Non-Routine Proposals

If beneficial owners fail to vote their shares or provide voting instructions to brokers and banks on routine management proposals, the NYSE and Amex permit member brokers and banks to vote the shares. In these cases, there is a broker vote, and it can be substantial. For example, in 1998 brokers voted over 28% of Intel Corporation's shares and 60% of Bio-Tech General's shares on routine management proposals. For non-routine management and shareholder proposals, the securities exchanges prohibit members from voting uninstructed shares, which results in a broker non-vote.

The NYSE and Amex classify management proposals as either routine or non-routine, with routine matters including any matter that is not non-routine. NYSE Rule 452, which Amex Rule 577 largely mirrors, classifies matters as non-routine if they fall into one of 18 categories. Examples include mergers and consolidations; authorizations or issuances of stock or stock options to directors, officers, or employees in amounts that exceed 5% of outstanding common shares; and acquisitions of property, assets, or a company, where the fair market value exceeds 20% of the firm's market value. (See Appendix A for a complete listing.) Although the

NASD does not have a rule for Nasdaq brokers that parallels these rules, many of its brokers, who also are members of the NYSE or Amex, vote uninstructed shares of Nasdaq-listed firms for beneficial owners on routine matters.¹

Thus, routine management proposals include matters such as uncontested elections of directors; authorizations of common equity; authorizations or issuances of stock or stock options to directors, officers, or employees in amounts of no more than 5% of outstanding common shares; and many others. Although securities exchanges classify these matters as routine, shareholders may perceive them as important. For example, an uncontested election of directors includes any election where not all shareholders are solicited by mail. So if dissidents solicit only shareholders who own more than 5,000 shares, or solicit shareholders exclusively over the Internet rather than by mail, an election is considered to be uncontested. In addition, managers can craft proposals' structures so they are classified as routine, rather than non-routine, thereby receiving brokers' votes. For stock-option plans, firms that seek to issue 15% of shares outstanding to officers and directors can propose a plan in each of several years for less than 5% of shares outstanding each year, ensuring routine proposal classifications (Wagner and Kersten, 1998). Monaco (2000) finds that 63% of stock-option plans proposed in early 1999 had no more than 4.9% dilution—a level that ensures routine classifications from the NYSE and Amex. Of course, managers may also have chosen less than 5% dilution for other reasons. However, Richard Wagner, president of Strategic Compensation Research Associates, observes that these days, he is "surprised when he sees a [stock-option plan] request for more than 5%. They [Companies] are gaming the system."²

Brokers are required to notify beneficial owners that they will vote uninstructed shares on routine management proposals. However, in a 1998 survey of people who invested in individual stocks, 77% of respondents indicated that they were not aware of brokers' ability to vote beneficially owned uninstructed shares.³ In addition, brokers are not required to inform shareholders and do not disclose how they plan to vote uninstructed shares. In fact, brokers vote beneficial owners' uninstructed shares in favor of management. The SEC conducted two surveys of brokerage firms to determine how they vote uninstructed shares. In 1976, all 118 respondents in a survey of brokerage firms indicated they always voted beneficial owners' uninstructed shares with management.⁴ In 1998, the SEC polled six of the largest brokerage firms, all of which indicated they voted uninstructed shares for management.⁵

Because brokers cast uninstructed street-name shares in support of management, broker votes can dislocate shares' voting and cash-flow rights, conferring a significant vote-getting advantage on managers. Such an advantage may impose agency costs on shareholders

¹The NASD recently filed a rule proposal that mirrors NYSE Rule 452 and Amex Rule 577. See SEC Release No. 34-42238, File No. SR-NASD-99-63, Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by National Association of Securities Dealers, Inc. to Allow NASD Members to Give Proxies in the Absence of Written Instructions from Beneficial Owners, 12/22/99. NYSE Rule 452 and Amex Rule 577 pertain to member firms of the exchanges; that is, member brokers and banks.

²David Henry, "Shareholder Votes Fall Through Loophole," *USA Today*, 8/26/99.

³See NYSE Rule 452: "A Study of the Rule's Usefulness and Propriety," prepared by M. Iovine, J. Page, A. Parylak, C. Reynolds, A. Sweetman, R. Yu at Rutgers University, copyright Corporate Investor Communications, Inc., November 1998.

⁴*Final Report on the Practice of Recording the Ownership of Securities in the Records of the Issuer in Other than the Name of the Beneficial Owner of Such Securities*, 1976, p. 15.

⁵See also the letter dated 5/5/99 from S. Teslik, Council of Institutional Investors, to A. Nazareth and G. Corso, US SEC. Although many brokerage firms also have asset management departments, the asset management and brokerage functions are separate and are regulated by different sets of rules and by different external entities. Asset managers typically have a fiduciary duty and, in many instances, a legal obligation to vote shares, thus their votes do not appear as broker votes.

similar to those imposed by other ownership structures that separate voting and cash-flow rights. (For example, see Bacon, Cornett, and Davidson, 1997; Bebchuk, Kraakman, and Triantis, 2000; and Kunz and Angel, 1996.)

Such dislocations have increasingly captured investors' attention during the past decade. For example, the International Corporate Governance Network, with members from over 22 countries that control assets in excess of \$8 trillion, has expressed concern about the practice of counting broker votes on corporate resolutions without first obtaining instructions from shareholders.⁶ The Council of Institutional Investors (CII) also has lobbied the NYSE and SEC to change the treatment of broker votes.⁷

C. Institutional Investor Voting

Perhaps offsetting some of the advantage that managers receive from broker votes are the increasingly coordinated activities of institutional investors in the voting process. Trade organizations, such as the CII, facilitate communication on voting related issues among large investors. Shareholder-voting advisory services, such as ISS, provide proxy analysis and voting recommendations. ISS covers over 12,500 companies and has more than 500 institutional investor subscribers worldwide.⁸ ISS is credited with influencing or playing a role in several contested situations, including Student Loan Marketing Association, Rexene Corp., RJR Nabisco Holdings Corp., and more recently, the merger proposal between Hewlett Packard Co. and Compaq Computer Corp.⁹

III. Factors Affecting Shareholder Voting

Shareholder voting is likely to depend on the types of issues that managers and shareholders include on ballots. We anticipate that voting turnout and the percentage of votes favorable to management will be higher when proposals are routine than when they are either non-routine or submitted by shareholders. First, brokers are allowed to vote uninstructed shares for routine management proposals. Second, because routine proposals are likely to be less controversial than non-routine management and shareholder proposals, they may generate votes favorable to management. In some instances, we anticipate that proposal passage may be swung because of a routine rather than non-routine classification.

Other factors may also affect voting turnout and votes favorable to management. For example, we expect that ISS recommendations unfavorable to management will be associated with fewer votes cast in favor of management. In addition, we anticipate the use of external proxy solicitation services will be related to shareholder voting. Managers retain external proxy solicitors to advise them on proxy issues, educate shareholders, and seek votes favorable to management. Although one might expect the use of external proxy solicitation services to result in higher voting turnout and votes favorable to management, we recognize

⁶See: http://www.icgn.org/conf2k/share_voting.html.

⁷See the letter dated 5/20/99 from S. Teslik, Council of Institutional Investors, to R. Grasso, NYSE, copied to US SEC Commissioners (A. Levitt, Jr., P. Carey, I. Hunt, N. Johnson, and L. Unger). In this letter, Teslik details previous communications with the US SEC regarding this issue. See also the letter dated 6/19/99 from S. Teslik, Council of Institutional Investors, to R. Grasso, NYSE, copied to US SEC Commissioners (A. Levitt, Jr., P. Carey, I. Hunt, N. Johnson, and L. Unger).

⁸See: <http://www.issproxy.com>.

⁹See "Advisory Firm's Influence Grows in Proxy Fights," *The Wall Street Journal*, 11/10/97, p. C1 and "H-P Gamers Major Endorsement of Deal," *The Wall Street Journal*, 03/06/02, p. A3.

managers may hire external proxy solicitors when they expect voting turnout or proposal passage to be problematic. That is, the use of solicitors may be associated with low turnout and few votes cast in support of management. Note that issuers, and therefore proxy solicitors, know the identities of registered owners because they hold shares directly. However, issuers may not know the identities of beneficial owners. Beneficial owners designate themselves as either non-objecting or objecting. Non-objecting beneficial owners are willing to have brokers share their identities with issuers and proxy solicitors, whereas objecting beneficial owners are not. Issuers and proxy solicitors must gather information from other sources about objecting beneficial owners.

Proposals' passage requirements may also affect voting results and passage. State securities laws broadly specify passage requirements, although firms may alter them by amending their bylaws and charters (Schneider, 1998). However, for specific meetings, proposal passage requirements are largely predetermined and beyond managers' immediate control. Passage is likely to be more difficult if a proposal requires a supermajority rather than majority of votes to pass and if passage depends on a percentage of eligible votes rather than votes cast. Under a votes-eligible passage requirement, the percentage of votes cast in favor of a proposal is calculated as the number of votes cast for a proposal divided by eligible votes. The denominator is invariant to the number of votes cast. In contrast, under a votes-cast passage requirement, the percentage of votes cast in favor is calculated as the number of votes cast for a proposal divided by total votes cast. Thus, a given number of affirmative votes tends to result in a lower percentage of affirmatively cast votes if passage depends on eligible votes rather than votes cast.

Firm size and performance may also affect shareholder voting and results. Larger firms are more likely to receive shareholder proposals and expend resources hiring proxy solicitors than smaller firms. Poorly performing firms, which tend to be targeted by activist investors (Opler and Sokobin, 1999), generally receive weaker shareholder support for management proposals and stronger support for shareholder proposals than more prosperous firms (Gillan and Starks, 2000).

Share turnover and ownership structure are other factors that are likely to affect voting turnout and results. Share turnover, defined as the total shares traded between a firm's record and meeting dates as a proportion of primary shares outstanding, should be negatively associated with voting turnout. Investors who sell their shares after a firm's record date and who thus have voting rights, but not cash-flow rights, are likely to lose interest in the company after they sell their shares. This separation of economic interest from voting rights may reduce investors' incentives to vote. Share turnover will be negatively associated with votes cast in favor of management under two circumstances. First, if investors who sell their shares disproportionately vote against management, or second, if the proportion of investors who oppose management increases.

Voting turnout should be higher for firms where shareholdings are concentrated amongst large blockholders, institutions, and insiders. Because their holdings are concentrated, owners of large blocks of shares are more likely than owners of fewer shares to garner sufficient benefits from monitoring and voting to justify the attendant costs. Blockholders are also among the shareholders most likely to have enough votes to launch a proxy contest or precipitate a takeover if management is not willing to change corporate policy (Shleifer and Vishny, 1986). Institutional investors typically have a fiduciary duty to vote shares and therefore do so (Del Guercio, 1996). Company insiders, who have a vested interest in voting outcomes, are also likely to vote.

Voting support for management also should depend on the percentage of shares owned by

large blockholders, institutions, and insiders. It is difficult, however, to predict definitively how owners of large blocks of shares will vote on proposals. Some empirical evidence suggests that blockholders act in concert with management (e.g., Dann and DeAngelo, 1988). However, other research indicates that blockholders may pressure managers to change corporate policies, enhancing shareholder wealth (e.g., Barclay and Holderness, 1991; Bethel, Liebeskind, and Opler, 1998; Holderness and Sheehan, 1985; Mikkelsen and Ruback, 1985). Regardless of how they vote, managers have, on average, incentives to include proposals only if they believe they will pass. We should therefore not observe many management proposals being included on ballots if management does not anticipate blockholder support. It is also difficult to predict how institutions will vote. Institutions historically have voted with managers. Increasingly, however, they are voting against them (e.g., Carleton et al. 1998; Gillan and Starks, 2000). Finally, we expect company insiders to vote with management. Thus, we expect a higher percentage of votes favorable to management when company insiders hold large blocks of shares than when their holdings are small.

IV. Company Characteristics

We focus on companies included in S&P's November 1997 Super-Composite 1,500 that had annual meetings during the 1998 proxy season. From this dataset, we exclude 20 foreign firms and 106 firms that either: 1) merged or were acquired before their 1998 meeting, 2) had a contested election of directors, 3) held a special meeting before their 1998 annual meeting or held only a special meeting in 1998, or 4) went bankrupt or were restructured. In Table I, we classify the remaining 1,374 firms according to whether their 1998 proxy statement included: 1) only director election and/or auditor ratification proposals (537 firms); 2) director election, auditor ratification, and other management proposals (640 firms); 3) director election, auditor ratification, and shareholder proposals (92 firms); or 4) director election, auditor ratification, other management, and shareholder proposals (105 firms). We note that we were not able to locate information for all proposals. For example, 35 companies did not disclose voting results for 55 proposals, and we cannot determine passage requirements for three proposals. We base subsequent analyses on the set of firms and proposals for which all required information is available.

Table I reports the means of firms' financial characteristics and ownership structures, along with their use of proxy solicitors. (A full description of data items and sources appears in Appendix B.) We compare the characteristics of firms in each of the last three groups with firms in the first group; that is, firms that included only director election and/or auditor ratification proposals. The table shows the statistical significance of differences in distribution between the director election and auditor ratification group and the other proposal groups, using two-tailed Wilcoxon rank-sum or chi-squared tests.

Table I indicates that firms that included director election, auditor ratification, and other management proposals in their proxy statements had higher market-to-book ratios, market-adjusted returns, industry-adjusted returns, and price/earnings ratios than firms with only director election and/or auditor ratification proposals. They had less debt in their capital structures, more share turnover, and larger insider holdings than firms with only director election and/or auditor ratification proposals. One interpretation of these findings is that managers included proposals when performance was good and they anticipated shareholder support. Managers also appear to have been likely to include proposals when they had sufficient holdings to influence voting results and were likely to obtain a large broker vote for routine management proposals.

Table 1. Company Characteristics Classified by Types of Proposals Included in Proxy Statements

The table shows the means of firms' financial characteristics and ownership structures and their use of proxy solicitors, classified by the types of proposals included in proxy statements. The sample consists of 1,374 firms from the November 1997 S&P Super-Composite 1,500 index. We measure the variables as of firms' fiscal year-ends before meetings. "MV" is equity market valuation. "M/B" equals the ratio of the market value of a firm's equity to the net book value of its physical assets. "ROA" equals earnings before interest, taxes, depreciation, and amortization divided by net assets. "One-Year Market-Adjusted Performance" is a firm's one-year stock return net of the market's one-year return. "P/E" is the company's price divided by earnings per share. "One-Year Industry-Adjusted Performance" is a firm's one-year stock return net of its primary 2-digit SIC code industry one-year return. "Debt/Assets" is the debt-to-asset ratio. "Share Turnover" is the total shares traded between a firm's record and meeting dates as a proportion of primary shares outstanding. "Block Ownership" is the percentage of shares owned by investors that have bought at least 5% of a firm's outstanding common stock. "Insider Ownership" is the percentage of shares owned by a firm's officers, directors, or their families. "Institutional Ownership" is the percentage of shares owned by institutions. "Percentage Using an External Solicitor" indicates the percentage of companies that used external proxy solicitation services. "Solicitation Expense" is the mean amount spent by companies on solicitors, excluding solicitors' out-of-pocket expenses. Statistical comparisons of the director election and auditor ratification proposal group with the other proposal groups were carried out with two-tailed Wilcoxon rank-sum or chi-squared tests for differences in distribution.

| | Firms w/ Director Election & Auditor Ratification Proposals | Firms w/ Director Election, Auditor Ratification, & Other Management Proposals | Firms w/ Director Election, Auditor Ratification, & Shareholder Proposals | Firms w/ Director Election, Auditor Ratification, Other Management, & Shareholder Proposals |
|---------------------------------------|----------------------------------------------------------------------|--------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------|
| MV (\$M) | 3,832 | 3,344 | 23,766*** | 15,740*** |
| M/B | 3.36 | 3.87*** | 3.39 | 4.24 |
| ROA (%) | 4.68 | 5.30 | 5.84 | 4.98 |
| 1-Yr. Market-Adj. Perf. (%) | -6.46 | 5.68*** | -7.00 | 1.97*** |
| 1-Yr. Industry-Adj. Perf. (%) | -4.46 | 4.88*** | -6.92 | -0.71 |
| P/E | 26.26 | 34.00*** | 21.30 | 25.14 |
| D/A (%) | 22.58 | 21.11** | 28.23*** | 26.51 |
| Share Turnover | 18.45 | 24.68*** | 14.61 | 16.63 |
| Block Ownership (%) | 36.05 | 34.29 | 23.69*** | 25.47* |
| Insider Ownership (%) | 7.27 | 8.49*** | 3.99*** | 3.70 |
| Institutional Ownership (%) | 59.33 | 59.83 | 60.56 | 61.57 |
| % Using an External Solicitor | 55.12 | 64.06*** | 87.00*** | 87.62*** |
| Solicitation Expense (\$) | 8,092 | 8,411 | 14,304*** | 14,149*** |
| Solicitation Expense/Shareholder (\$) | 2.56 | 3.91*** | 1.48*** | 1.07*** |
| Number of Firms | 537 | 640 | 92 | 105 |

***Significant at the 0.01 level.

**Significant at the 0.05 level.

*Significant at the 0.10 level.

Table I shows firms that had at least one shareholder proposal, but no management proposals other than director election and/or auditor ratification proposals in their proxy statements had larger market capitalizations, greater financial leverage, lower block ownership, and smaller insider holdings than firms with only director election and/or auditor ratification proposals. The table also indicates that firms that included director election, auditor ratification, other management, and shareholder proposals in their proxy statements had larger market capitalizations, higher market-adjusted returns, and lower block ownership than firms with only director election and/or auditor ratification proposals. The results in these columns show that firms that received shareholder proposals were larger, had lower blockholdings, and performed no worse than firms with only director election and/or auditor ratification proposals. The insider-holdings result is not surprising. One would expect non-insider shareholders to exert their influence through shareholder proposals when the chance of success is high and when the need to exert influence is large; that is, when managers have relatively few votes and when managers' incentives are not aligned with other shareholders' because they do not own much stock.

Table I also shows managers retained proxy solicitors, especially when ballots included management proposals other than director election and auditor ratification proposals and shareholder proposals.¹⁰ This evidence is consistent with managers actively managing the voting process on more controversial proposals. Firms' average external proxy solicitation expenses (excluding solicitors' out-of-pocket expenses) and external proxy solicitation expenses per shareholder were higher when shareholders submitted proposals than when firms included only director election and/or auditor ratification proposals.

V. Results

In this section, we present analyses of the voting turnout and results. Subsection A discusses the results of the univariate analyses, and Subsection B presents the findings of the multivariate analyses.

A. Univariate Voting Analyses

Here we present univariate analyses of the voting results. In Subsection 1, we outline the voting metrics used and report voting results. In Subsection 2, we study the impact of broker voting on voting turnout and results. In Subsection 3, we examine the impact of ISS recommendations on shareholder voting. To investigate potential harm to shareholders, we focus on swung proposals for which ISS recommended shareholders vote against.

1. Voting Metrics and Voting Results

The SEC requires companies to report "...votes cast for, against, abstentions and broker non-votes." However, for routine proposals there are no broker non-votes because broker votes of beneficially owned uninstructed shares are included among the votes cast favorable to management and are not reported separately. For non-routine management and shareholder proposals, brokers are precluded from voting uninstructed shares, and we thus observe broker non-votes. We note that the absence of the serial comma in the SEC's rule appears to leave room for interpretation. Some companies disclose four categories of votes, but others,

¹⁰We do not find a statistically significant difference in firms' average external proxy solicitation expenses, excluding solicitors' out-of-pocket expenses, across different classes of management proposals.

by combining abstentions and broker non-votes, report only three. Thus, in a small number of instances, we are not able to obtain broker non-vote information, even for non-routine management and shareholder proposals.

We use several metrics to characterize shareholder voting. First, "Voting Turnout," which is our proxy for the level of shareholder participation, is the sum of all votes cast (including for and against votes and abstentions) as a percentage of eligible votes. Where we observe broker non-votes (i.e., non-routine management and shareholder proposals), we do not include them in the number of votes cast, because we do not consider them to be actively cast by shareholders. Second, "Votes Cast For: Company Passage Requirement," indicates the percentage of votes cast in favor of management based on a company's passage requirement. We note that a vote cast against a shareholder proposal is a vote cast in favor of management. As discussed previously, state laws prescribe proposals' passage requirements, although firms may alter them by amending bylaws and charters. Thus, we observe variations in passage requirements that affect voting results and proposal passage. Third, "Votes Cast For: Eligible Votes" indicates the number of votes cast in favor of management as a percentage of eligible votes. We provide this metric so that we can better understand the impact of firms' passage requirements on voting results and proposal passage. Fourth, "Votes Cast Against" is the number of votes cast against management's recommendation as a percentage of eligible votes. Fifth, for non-routine management and shareholder proposals, "Broker Non-Vote" measures the number of beneficially owned uninstructed votes as a percentage of eligible votes. Finally, for all proposals, we calculate abstentions as a percentage of eligible votes.

Table II shows the mean voting results for routine management proposals, and Table III reports mean voting results for non-routine management and shareholder proposals. Each table reports the number of proposals submitted for shareholder vote. The tables show that the most common type of management proposal seeks the adoption of equity-based compensation plans. There are also many proposals to add shares to existing equity-based compensation plans. Amendments to equity-based compensation plans generally take the form of changing participant eligibility, altering a plan's life or altering the level and timing of grants.

Other categories of proposals include acquiring or being acquired, approving bonus plans, approving or repealing anti-takeover-related measures (including poison pills, supermajority passage requirements, classified boards, dual-class stocks, preferred stocks, reincorporating firms, changing boards, and the like), changing company names, increasing authorized equity, undertaking legal restructurings, and certain other proposals. (The category "other" includes proposals such as the approval of technical charter amendments, board composition or size, and the amendment of indemnification provisions.) We classify shareholder proposals as either corporate governance or social proposals.

Several results of Table II and Table III are important. First, Table II shows that brokers are able to vote beneficial owners' uninstructed shares on more than two-thirds (806 out of 1,173) of management proposals other than director elections and auditor ratifications, and do so on a wide range of issues. In 1998, brokers voted beneficially owned uninstructed shares for management proposals in seven of the 11 management proposal categories.

Voting turnout for routine management proposals, which ranges from 86.2% to 88.7%, is relatively high. Voting turnout for non-routine proposals is somewhat lower, due, at least in part, to the exclusion of broker non-votes as actively voted shares.

Table III compares routine and non-routine management proposals' voting turnouts and results by proposal type (when possible) by using Wilcoxon t-tests for differences in distribution. The table indicates significant differences in voting turnout and results for different types of proposals conditioned on whether they were classified as routine or non-routine.

Table II. Shareholder Votes on Routine Management Proposals

The table shows the number of routine management proposals and mean levels of voting turnout, votes cast for and against proposals, and abstentions, classified by proposal type. The sample consists of 1,374 firms from the November 1997 S&P Super-Composite 1,500 index. "Voting Turnout" is the number of votes cast for, against, and abstained as a percentage of eligible votes. "Votes Cast For" is the percentage of votes cast in favor of management based on a company's passage requirement and on eligible votes. "Votes Cast Against" is the number of votes cast against management's recommendation as a percentage of eligible votes. "Abstentions" is the number of abstentions by shareholders as a percentage of eligible votes.

| | No. of Routine Proposals | No. of Routine Proposals with Voting Information | Voting Turnout (%) | Votes Cast For: Company Passage Requirement (%) | Votes Cast For: Eligible Votes (%) | Votes Cast Against (%) | Abstentions (%) |
|----------------------------------------------|--------------------------------|--------------------------------------------------------------|--------------------------|-------------------------------------------------------------|---------------------------------------------|---------------------------------|--------------------|
| <i>Management Proposals:</i> | | | | | | | |
| Acquire or be Acquired | 0 | 0 | | | | | |
| Adopt Equity-Based Compensation Plan | 223 | 213 | 87.0 | 87.3 | 76.1 | 10.0 | 0.9 |
| Add Shares to Equity-Based Compensation Plan | 187 | 180 | 86.2 | 84.6 | 72.8 | 12.4 | 1.0 |
| Amend Equity-Based Compensation Plan | 56 | 53 | 86.2 | 91.3 | 79.2 | 6.2 | 0.8 |
| Approve Bonus Plan | 96 | 87 | 86.4 | 94.4 | 81.7 | 3.8 | 0.9 |
| Approve Related-Related Measure | 0 | 0 | | | | | |
| Repeal Related-Related Measure | 0 | 0 | | | | | |
| Change Name | 14 | 14 | 86.8 | 87.6 | 84.3 | 2.0 | 0.6 |
| Increase Authorized Equity | 197 | 188 | 86.9 | 80.7 | 77.8 | 8.8 | 0.4 |
| Restructure | 0 | 0 | | | | | |
| Other | 33 | 31 | 88.7 | 88.6 | 82.7 | 4.7 | 1.3 |
| Total/Average for Management Proposals | 806 | 766 | 86.7 | 86.2 | 77.0 | 9.0 | 0.8 |

Table III. Shareholder Votes on Non-Routine Management and Shareholder Proposals

The table shows the number of non-routine management and shareholder proposals, and the mean levels of voting turnout, votes cast for and against proposals, abstentions, and broker non-votes, classified by proposal type. The sample consists of 1,374 firms from the November 1997 S&P Super-Composite 1,500 index. "Voting Turnout" is the number of votes cast for, against, and abstained as a percentage of eligible votes. "Votes Cast For" is the percentage of votes cast in favor of management based on a company's passage requirement and on eligible votes. "Votes Cast Against" is the number of votes cast against management's recommendation as a percentage of eligible votes. "Abstentions" is the number of abstentions by shareholders as a percentage of eligible votes. "Broker Non-vote" is the number of votes cast by brokers on behalf of beneficial owners as a percentage of eligible votes.

| | No. of Proposals | No. of Proposals with Voting Info. | Voting Turnout (%) | Votes Cast For: | | | Votes Cast Against (%) | Broker Abstentions (%) | Non-Votes (%) |
|----------------------------------------------|------------------|------------------------------------|--------------------|--------------------------|--------------------|--------------------------|------------------------|------------------------|---------------|
| | | | | Company Passage Req. (%) | Eligible Votes (%) | Company Passage Req. (%) | | | |
| <i>Management Proposals:</i> | | | | | | | | | |
| Acquire or be Acquired | 8 | 7 | 71.8 | 90.3 | 69.6 | 1.1 | 1.1 | 12.6 | |
| Adopt Equity-Based Compensation Plan | 147 | 144 | 77.4*** | 81.5*** | 63.8** | 12.3 | 1.3 | 12.6 | |
| Add Shares to Equity-Based Compensation Plan | 93 | 89 | 74.0*** | 77.5*** | 59.2** | 14.2 | 0.7 | 15.3 | |
| Amend Equity-Based Compensation Plan | 6 | 6 | 83.8*** | 80.8* | 69.9 | 12.8 | 1.1 | 10.1 | |
| Approve Bonus Plan | 19 | 18 | 80.2*** | 93.3 | 75.0** | 4.6 | 0.6 | 10.7 | |
| Approve Related-Related Measure | 30 | 29 | 75.9 | 62.9 | 56.6 | 18.1 | 1.2 | 11.6 | |
| Repeal Related-Related Measure | 15 | 14 | 72.4 | 72.7 | 68.6 | 2.2 | 1.7 | 19.0 | |
| Change Name | 2 | 2 | 81.0* | 79.9 | 79.9 | 0.5 | 0.6 | 6.3 | |
| Increase Authorized Equity | 24 | 24 | 81.7*** | 70.1*** | 66.8** | 14.4 | 0.5 | 11.4 | |
| Restructure | 5 | 5 | 78.8 | 77.3 | 77.3 | 1.1 | 0.3 | 10.3 | |
| Other | 18 | 18 | 71.4*** | 74.2*** | 67.1** | 3.6 | 0.7 | 16.7 | |
| Total/Average for Management Proposals | 367 | 356 | 76.4*** | 78.2* | 63.8** | 11.7 | 1.0 | 13.6 | |
| <i>Shareholder Proposals:</i> | | | | | | | | | |
| Governance | 215 | 211 | 76.1 | 25.7 | 19.6 | 54.1 | 2.4 | 11.1 | |
| Social | 109 | 109 | 76.2 | 8.3 | 6.0 | 66.0 | 4.2 | 11.0 | |
| Total/Average for Shareholder Proposals | 324 | 320 | 76.1 | 19.8 | 15.0 | 58.2 | 3.0 | 11.0 | |

***Significant at the 0.01 level.

**Significant at the 0.05 level.

*Significant at the 0.10 level.

For virtually all proposal categories, companies' passage requirements enhance the percentage of votes favorable to management, and potentially the passage of the proposal. Table II indicates that, on average, the percentage of votes cast favorable to management for routine management proposals would fall from 86.2% to 77% if passage was based on a percentage of eligible votes rather than on companies' passage requirements. Similarly, the percentage of votes cast favorable to management for non-routine management proposals would fall from 78.2% to 63.8%.

2. The Impact of Broker Voting

The analyses in Table II and Table III indicate broker votes play an important role in determining voting results. On average, routine management proposals receive 8% more votes favorable to management than do non-routine proposals of the same proposal type and 10.3% higher voting turnout. These differences are statistically significant beyond the 1% level. We find that routine management proposals receive as many as 14.4% more votes cast favorable to management than non-routine proposals of the same proposal type, and as much as 17.3% higher voting turnout, depending on proposal type. Table III shows that broker non-votes averaged 13.6% of the eligible votes for non-routine management proposals and 11% for shareholder proposals. These findings are broadly consistent with Brickley et al. (1994) which find that routine share-authorization proposals between 1984 and 1986 received 15% more favorable votes than non-routine anti-takeover proposals. If brokers' votes had not been counted for the routine proposals shown in Table II (assuming the broker votes by proposal type in Table II were the same percentage of eligible votes as the broker non-votes shown in Table III), we estimate that average voting turnout for routine proposals would fall from 86.7% to 76.4%.

Table IV provides further evidence on the potential impact of broker votes on shareholder voting. For each category of non-routine management and shareholder proposals, Table IV reports a range of broker non-votes and the number of proposals in each range. Over 70% of proposals have broker non-votes greater than 10%, and 12.6% have broker non-votes greater than 30%. Although brokers could not vote uninstructed shares for these proposals, the findings indicate the magnitude of broker votes that may be included in votes cast favorable to management on routine proposals.

A key question is whether broker votes increase the chance that routine management proposals pass. To study this issue, we estimate voting outcomes for such proposals by assuming brokers could not have voted beneficial owners' uninstructed shares. For routine proposals at firms that also have either non-routine management or shareholder proposals, we estimate broker votes by using the broker non-votes reported for the same firm's non-routine management or shareholder proposals. For routine proposals submitted by managers of firms that have neither non-routine management nor shareholder proposals, we estimate the percentage of broker votes based on proposal and firm characteristics. Using a sample of non-routine management and shareholder proposals (where we can observe broker non-votes), we estimate coefficients for proposal and firm characteristics. We then use these coefficients and proposal and firm characteristics to estimate the percentage of broker votes for routine proposals. We estimate broker votes based on dummies indicating proposal type, dummies for voting rules, firm size, share turnover, proxy solicitation expense, and share ownership. We then use companies' passage requirements to determine whether proposals would pass without broker votes.

Table V shows the number and percentage of routine management proposals whose passage we estimate was swung by broker votes. We classify the results by whether the passage

Table IV. Distribution of Broker Non-Votes by Proposal

The table shows the number of proposals that fell into each range of broker non-votes for non-routine management and shareholder proposals, classified by proposal type. The sample consists of 493 proposals at 289 firms from the November 1997 S&P Super-Composite 1,500 index for which values for broker non-votes are reported. The broker non-vote is based on companies' passage requirements.

| | Number of Proposals Falling Into Broker Non-Vote Ranges | | | | | | | |
|----------------------------------------------|---------------------------------------------------------|-------|--------|--------|--------|--------|--------|-------|
| | 1-5% | 5-10% | 10-15% | 15-20% | 20-25% | 25-30% | 30-40% | ≥ 40% |
| <i>Management Proposals:</i> | | | | | | | | |
| Acquire or be Acquired | 12 | 19 | 27 | 14 | 1 | 4 | 6 | 8 |
| Adopt Equity-Based Compensation Plan | 8 | 6 | 15 | 13 | 5 | 4 | 12 | 7 |
| Add Shares to Equity-Based Compensation Plan | 1 | | | 1 | 1 | | | |
| Amend Equity-Based Compensation Plan | | 5 | 4 | 1 | | 1 | 1 | 1 |
| Approve Bonus Plan | 4 | 5 | 7 | 4 | 6 | 1 | 1 | 1 |
| Related-Related | 2 | 4 | 7 | 1 | 1 | 1 | | |
| Increase Authorized Equity | 1 | 5 | 1 | | | 2 | 2 | 1 |
| Restructure | | | | | | | | |
| Other | 28 | 44 | 69 | 34 | 20 | 13 | 22 | 18 |
| <i>Total for all Management Proposals:</i> | | | | | | | | |
| <i>Shareholder Proposals:</i> | | | | | | | | |
| Governance | 10 | 33 | 56 | 30 | 14 | 1 | 9 | 6 |
| Social | 2 | 27 | 21 | 18 | 9 | 1 | 4 | 4 |
| <i>Total for all Shareholder Proposals:</i> | | | | | | | | |
| <i>Total for all Proposals:</i> | 40 | 104 | 146 | 82 | 43 | 15 | 35 | 28 |

Table V. Number and Percentage of Routine Management Proposals and Routine Stock-Option Plan Proposals Whose Passage is Estimated to Have Been Swung by Broker Votes

The table presents estimates of the number and percentage of routine management proposals and routine stock-option plan proposals whose passage may have been swung by broker votes (that is, assuming brokers could not have voted beneficial owners' uninstructed shares). Passage is based on companies' passage requirements. The samples consist of all routine proposals for 1,374 firms from the November 1997 S&P Super-Composite 1,500 index for which the required data is available. To calculate percentages, we use the denominator in each category of the table that corresponds to the set of proposals in the category for which all relevant data is available.

| | Proposal Passage Requirement | | |
|------------------------------------------------------------------------------------------------------------------------------------|------------------------------|-------------------|-------------------|
| | Votes Eligible | Votes Cast | All |
| <i>Panel A. Routine Management Proposals</i> | | | |
| Number of Routine Management Proposals whose Passage is Estimated to have been Swung by Broker Votes/Number in Category (%) | 23/187 (12.3%) | 50/574 (8.7%) | 73/761 (9.6%) |
| Number of Routine Stock-Option Plan Proposals whose Passage is Estimated to have been Swung by Broker Votes/Number in Category (%) | 4/15 (26.7%) | 42/374 (11.2%) | 46/389 (11.8%) |
| <i>Panel B. Routine Management Proposals where ISS Issued Recommendations Unfavorable to Management</i> | | | |
| Number of Routine Management Proposals whose Passage is Estimated to have been Swung by Broker Votes/Number in Category (%) | 15/38 (39.5%) | 41/121 (40.6%) | 56/159 (35.2%) |
| Number of Routine Stock-Option Plan Proposals whose Passage is Estimated to have been Swung by Broker Votes/Number in Category (%) | 3/5 (60.0%) | 37/101 (36.6%) | 40/106 (37.7%) |

requirement is based on eligible votes or votes cast. Table V, Panel A, shows that broker votes may have swung the passage of as many as 73 out of 761 – or 9.6% – of all routine management proposals. Thus, in a single year, we estimate that managers may have overridden shareholders' preferences 73 times.

When we classify proposals by passage requirement, we find that broker votes may have swung the passage of up to 12.3% of proposals with passage requirements of votes eligible, and up to 8.7% of proposals with passage requirements of votes cast. Broker votes are especially important to the passage of proposals whose passage requirement is votes eligible. It appears that a passage requirement of votes cast enhances the probability of proposal passage, so firms do not have to rely as much on broker votes for proposal passage.

Of the 73 proposals whose passage may have been swung by broker votes, 46 proposals (at 43 companies) seek to adopt or add shares to stock-option plans, 21 request approval to issue or increase authorized common equity, three want approval of a by-law amendment to change board size, one seeks bonus-plan approval, one requests shareholder approval of a name change, and one asks for the approval of loans to officers. For proposals that seek to adopt or add shares to a stock-option plan, the average proposal dilution is 4.2% – below the 5% threshold required for non-routine proposal classification. However, the average total dilution resulting from the proposals is 19.6% (with total dilution ranging from 7.2% to 34.6%). Of the 43 companies that proposed stock-option plans, 31 adopted or added shares

to a stock-option plan at least once during the preceding three years. Of these, six companies had done so in each of the preceding three years, 11 had done so twice, and 14 had done so once. For the 21 proposals seeking to issue or increase authorized common equity, the median proposed increase is 200% of current shares outstanding. The proposed increases range from 25% to 212.5%. At a median increase of 200%, an investor's ownership stake would fall from 10% to as little as 3.3% if they owned 100 shares of a firm with 1,000 shares originally outstanding. From many shareholders' perspectives, these proposals could have significantly diluted their voting power and perhaps wealth.

In the sample, ISS recommended that investors vote against 78.1% (57) of the 73 proposals whose passage may have been swung by broker non-votes. In contrast, ISS recommended voting against 25% of management proposals in the full sample, not including uncontested director elections and auditor ratifications.

In addition to analyzing the full sample of proposals, we study a subsample of proposals that seek to adopt or add shares to stock-option plans. The finding discussed in Section II.B. that stock-option plan proposal dilution clusters below 5% suggests that managers may control the characteristics of stock-option plan proposals to capture broker votes. Studying these proposals' voting results may help us determine the relation between managerial control of the proxy process and voting in a homogeneous sample of proposals whose characteristics may have been actively managed. Moreover, stock-option plan proposals, which can dilute share ownership, have attracted the attention of many institutional investors, and thus may face greater shareholder scrutiny than other proposals.

Table V, Panel A, indicates that as many as 11.8% of routine stock-option plan proposals may have been swung by brokers' votes. Classifying stock-option plan proposals by passage requirement, we find the passage of 26.7% of proposals with passage requirements of votes eligible may have been swung by brokers' votes, and 11.2% of proposals with passage requirements of votes cast.

Broker votes were evidently important to proposal passage in 1998. We expect that they will become increasingly important as managers face heightened shareholder resistance to certain types of proposals, including proposals seeking shares for stock-options plans. For example, in 1989, shareholders voted 3.5% of shares against stock-option plan proposals. By 1999, this percentage had increased to 18.3% (Hambly, 2000).

Although we estimate which proposals' passage during the 1998 proxy season may have been swung by broker votes, not all of these proposals would necessarily have failed without broker votes. For example, without the ability to obtain broker votes, managers would have had incentives to pre-manage the proxy process by retaining proxy solicitors to enhance proposals' chance of passage or abandoning proposals altogether.

3. ISS Recommendations and Potential Shareholder Harm from Broker Votes

Prior research indicates ownership structures that separate voting and cash-flow rights impose agency costs on shareholders (Bebchuk et al., 2000; Horner, 1988; Lease, McConnell, and Mikkelsen, 1983; Megginson, 1990; Zingales, 1994). Thus, shareholders of firms in which voting and cash-flow rights are dislocated because of broker votes are likely to incur such costs. The market should discount shares' voting rights when brokers' votes are likely to be pivotal in elections and the private benefits to winning elections are significant (Zingales, 1995).

Ideally, we would like to estimate the share discounts associated with broker votes. However, Zingales (1995) notes that although voting rights should be priced, their values cannot be measured in publicly held firms that have single (as opposed to multiple) classes of equity.

We would also like to estimate the effect of broker votes on shareholder wealth, but to do so in an event-study context poses a number of problems. First, it is difficult to determine the appropriate event date. Possible dates include those of the proxy filing, the proxy mailing, the date on which ISS issued a voting recommendation, the date of the annual meeting, and the date on which the market knew the ownership structure of the firm and could ascertain the likelihood of proposal passage. It is also difficult to isolate the impact of specific information on share prices: Event dates are likely to coincide with the release of confounding information. For example, proxy statements contain information not only on targeted proposals, but also on executive compensation, new appointments to the board, other management proposals, shareholder proposals, and the like. Annual meetings are also likely to coincide with the release of other major corporate news.

Instead, we focus on ISS recommendations and analyses to gauge whether or not proposals are in shareholders' interests. We note that ISS recommendations can substantially affect voting results. A univariate comparison of voting results for proposals that receive favorable and unfavorable ISS recommendations to management indicates that unfavorable recommendations are associated with 13.6% to 20.6% fewer affirmative votes for management proposals, depending on specific proposal type (not tabled).

In Panel B of Table V, we estimate voting outcomes for routine management proposals and routine stock-option plan proposals, assuming that brokers could not have voted beneficial owners' uninstructed shares. We focus exclusively on proposals for which ISS issued voting recommendations unfavorable to management. Using the same method as in Panel A of Table V, we estimate that broker votes may have swung the passage of as many as 35.2% of all routine management proposals that ISS recommended voting against.

When we classify proposals by passage requirement, we find that the passage of 39.5% of proposals with passage requirements of votes eligible may have been swung by brokers' votes, and 40.6% of proposals with passage requirements of votes cast. When we focus on cases in which ISS recommended voting against management's routine stock-option plan proposals, shown in Table V, Panel B, we find that the passage of 37.7% of such proposals may have been swung by brokers' votes. The table also shows that the passage of 60% of stock-option plan proposals with passage requirements of votes eligible may have been swung by brokers' votes, and 36.6% with passage requirements of votes cast.

Further study of ISS analyses and recommendations suggests that successful proposals, which in 1998 included proposals that sought authorizations of additional shares and either adoptions of or additions of shares to stock-option plans, may not have been in shareholders' best interests. All 14 share authorizations that ISS recommended voting against requested authorizations of at least 100% of current shares outstanding. Most companies cited "ongoing flexibility" as the primary reason for their request and failed to disclose specific issuance plans. ISS did not consider this explanation as sufficient justification for such authorizations. Two companies also suggested that the increase would provide the ability to issue shares if a poison pill was triggered. In 1998, ISS generally recommended voting against anti-takeover related authorizations. ISS also recommended voting against stock-option plans for companies that had previously re-priced options without shareholder approval (18 cases); companies with policies expressly permitting repricing (17 cases); and where the estimated plan costs exceeded ISS's allowable caps (based on proposals' potential value-transfers relative to industry peers and levels deemed appropriate for specific companies) (27 cases). Twenty proposals triggered more than one of ISS's vote-against criteria.

B. Multivariate Voting Analyses

In this section, we present multivariate analyses of the voting results. In Subsection 1, we

provide an overview of the empirical approach. In Subsection 2, we study the impact of broker voting and ISS recommendations on voting turnout and shareholder voting.

1. Overview

The univariate results suggest that broker votes on routine proposals increased the votes cast favorable to management. Therefore, a central question is whether the institutional and regulatory environment affects voting turnout and results in a multivariate setting. In Table VI, we study the determinants of voting turnout, votes cast favorable to management as determined by companies' passage requirements, and votes cast favorable to management as a percentage of eligible votes. We do so for the full sample of proposals, and for a subsample of stock-option plan proposals.

Because voting turnout and results are bound by zero and one, we transform the voting metrics by using the transform $\log(\% \text{ vote}/(100-\% \text{ vote}))$. Consistent with the discussion in Sections II and III, we model voting turnout and results as a function of the proposal and firm characteristics. We include total dilution as a covariate in the stock-option plan regressions, because we have anecdotal evidence that strongly suggests that shareholders focus on total rather than proposal dilution.

2. Multivariate Voting Results

The univariate analyses suggest that voting recommendations from ISS may affect shareholder voting and proposal passage. Table VI, using a multivariate setting, shows that there are negative and statistically significant relations between the measures of votes cast favorable to management and recommendations from ISS that are unfavorable to management. The results support Morgan and Poulsen's (2001) finding of a statistically significant negative coefficient for a voting service's recommendations against management-sponsored compensation proposals.

Of course, ISS recommendations may be correlated with institutions' voting guidelines, and thus may be a proxy for institutions' interests. However, the analysis controls for dilution and other factors known to influence institutions' voting behavior. Therefore, the results suggest that ISS recommendations that are unfavorable to management may influence shareholder voting in and of themselves. The results are generally robust to a model specification including industry effects.

For proposals seeking additional shares for stock-option plans, we find statistically significant negative associations between both measures of votes cast and total dilution. Shareholders voted against proposals they believed to be dilutive.

For both samples, Table VI shows negative and statistically significant relations between voting turnout and the presence of non-routine management proposals. The same result holds for shareholder proposals in the full sample. These findings, which are consistent with the univariate results, capture the impact on voting turnout when brokers are not able to vote beneficial owners' uninstructed shares. The results could also reflect the possibility that non-routine management and shareholder proposals tend to be more controversial than routine management proposals.

We find that passage requirements based on a percentage of eligible votes are negatively associated with the percentage of votes cast favorable to management based on the company-voting rule. This finding is consistent with passage requirements of votes-eligible theoretically being associated with lower percentages of votes cast in favor of management. Supermajority passage requirements are not statistically related in any of the analyses.

We do not find statistically significant relations between voting turnout and firms' use of

Table VI. Cross-Sectional Regressions of Voting Turnout and Results

The table presents cross-sectional regressions explaining voting turnout and voting results, where the voting variables are $\log[\text{vote \%}/(100\% - \text{vote \%})]$. "Voting Turnout" is the number of votes cast as a percentage of eligible votes. "Votes Cast For: Company Passage Requirement" is the percentage of votes cast in favor of management based on companies' passage requirements. "Votes Cast For: Eligible Votes" is the number of votes cast in favor of management as a percentage of eligible votes. The samples consist of all proposals and all stock-option plan proposals for 1,374 firms from the November 1997 S&P Super-Composite 1,500 index. "ISS Recommendation" is one if ISS issued a recommendation unfavorable to management, and zero otherwise. "Total Dilution" is the total number of shares reserved for issuance, including shares authorized or issued if a proposal were adopted, divided by the firm's outstanding shares before authorization or issuance. The "Non-routine Management Proposal Dummy" equals one if a proposal was non-routine, and zero otherwise. The "Shareholder Proposal Dummy" equals one if shareholders submitted the proposal, and zero otherwise. The "Eligible Votes Dummy" equals one if the proposal passage depended on eligible votes, and zero otherwise. The "Supermajority Dummy" equals one if proposal passage depended on a supermajority of votes, and zero otherwise. "Solicitation Expense" is the amount spent by companies on proxy solicitors, excluding solicitors' out-of-pocket expenses. "MV" is equity market valuation. "One-Year Market-Adjusted Performance" is a firm's one-year stock return divided by the market's one-year return. "Share Turnover" is the total shares traded between a firm's record and meeting dates as a proportion of primary shares outstanding. "Block Ownership" is the percentage of shares owned by investors that have bought at least 5% of a firm's outstanding common stock. "Insider Ownership" is the percentage of shares owned by a firm's officers, directors, or their families. "Institutional Ownership" is the percentage of shares owned by institutions. We obtain accounting and stock return data from Compustat for the fiscal year-end preceding each meeting date. () indicates a p-value of whether a coefficient is different from zero.

| | All Proposals | | | | Stock-Option Plan Proposals | | | |
|----------------------------|---------------------|---------------------------------------------|--------------------------------|---------------------|---------------------------------------------|--------------------------------|--------------------------------|--|
| | Voting Turnout | Votes Cast For: Company Passage Requirement | Votes Cast For: Eligible Votes | Voting Turnout | Votes Cast For: Company Passage Requirement | Votes Cast For: Eligible Votes | Votes Cast For: Eligible Votes | |
| Intercept | 1.88 *** (0.00) | 3.18 *** (0.00) | 1.50 *** (0.00) | 2.31 *** (0.00) | 3.52 *** (0.00) | 1.63 *** (0.00) | 1.63 *** (0.00) | |
| ISS Recommendation | -0.01 (0.85) | -1.60 *** (0.00) | -0.84 *** (0.00) | -0.01 (0.88) | -1.64 *** (0.00) | -0.80 *** (0.00) | -0.80 *** (0.00) | |
| Total Dilution | | | | | | | | |
| Non-Routine Proposal Dummy | -0.73 *** (0.00) | -0.42 *** (0.00) | -0.56 *** (0.00) | -0.01 *** (0.01) | -0.01 * (0.08) | -0.01 *** (0.00) | -0.01 *** (0.00) | |
| Shareholder Proposal Dummy | -0.67 *** (0.00) | -0.71 *** (0.00) | -0.74 *** (0.00) | -0.75 *** (0.00) | -0.36 *** (0.00) | -0.51 *** (0.00) | -0.51 *** (0.00) | |
| Eligible Votes Dummy | 0.00 (0.98) | -1.22 *** (0.00) | 0.07 ** (0.03) | 0.04 (0.86) | -1.07 *** (0.00) | 0.11 (0.37) | 0.11 (0.37) | |

Table VI. Cross-Sectional Regressions of Voting Turnout and Results (Continued)

| | All Proposals | | | | | Stock-Option Plan Proposals | | | | |
|-------------------------------|---------------------|---------------------------------------------|--------------------------------|-------------------|---------------------------------------------|--------------------------------|----------------|---------------------------------------------|--------------------------------|--|
| | Voting Turnout | Votes Cast For: Company Passage Requirement | Votes Cast For: Eligible Votes | Voting Turnout | Votes Cast For: Company Passage Requirement | Votes Cast For: Eligible Votes | Voting Turnout | Votes Cast For: Company Passage Requirement | Votes Cast For: Eligible Votes | |
| Supermajority Dummy | -0.05 (0.75) | -0.02 (0.88) | 0.02 (0.81) | 0.44 (0.66) | 0.14 (0.88) | -0.09 (0.88) | | | | |
| log (Solicitation Expense) | 0.00 (0.66) | -0.02 *** (0.00) | -0.01 (0.17) | 0.01 (0.18) | -0.02 *** (0.01) | 0.00 (0.58) | | | | |
| log (MV) | -0.02 (0.15) | 0.11 *** (0.00) | 0.05 *** (0.00) | -0.04 (0.32) | 0.12 *** (0.00) | 0.05 *** (0.01) | | | | |
| 1-Yr. Mkt.-Adj. Perf. (%) | 0.00 (0.19) | 0.00 (0.74) | 0.00 (0.28) | 0.00 (0.46) | 0.00 (0.83) | 0.00 (0.90) | | | | |
| log (Share Turnover) | -0.01 *** (0.00) | -0.11 *** (0.00) | -0.10 *** (0.00) | -0.08 * (0.10) | -0.09 * (0.06) | -0.09 *** (0.00) | | | | |
| log (Block Ownership) | 0.05 ** (0.03) | 0.09 *** (0.00) | 0.08 *** (0.00) | 0.02 (0.66) | 0.12 *** (0.01) | 0.08 *** (0.00) | | | | |
| log (Insider Ownership) | 0.03 ** (0.03) | 0.06 *** (0.00) | 0.04 *** (0.00) | 0.02 (0.62) | 0.06 ** (0.05) | 0.02 (0.17) | | | | |
| log (Institutional Ownership) | 0.08 (0.17) | -0.23 *** (0.00) | -0.09 ** (0.03) | 0.07 (0.61) | -0.36 *** (0.00) | -0.10 (0.16) | | | | |
| N | 1321 | 1321 | 1321 | 589 | 589 | 589 | | | | |
| Adjusted-R ² | 0.21 | 0.54 | 0.55 | 0.15 | 0.49 | 0.47 | | | | |

***Significant at the 0.01 level.
 **Significant at the 0.05 level.
 *Significant at the 0.10 level.

external proxy solicitors in either sample. However, Table VI shows that external proxy solicitation expense is negatively related to votes cast in favor of management based on the companies' passage requirements. As discussed earlier, managers may preferentially retain external proxy solicitors when they anticipate resistance from shareholders.

In both samples, firm size is positively associated with the percentage of votes cast favorable to management. Firm performance, which we measure by one-year market adjusted performance, is not related either to voting turnout or to votes cast favorable to management. Share turnover is negatively associated with both vote turnout and votes cast in favor of management. It appears investors who sell their shares after a firm's record date and who therefore have voting rights, but not cash-flow rights, lose interest in companies after they sell their shares.

We find that in both samples, block ownership is positively associated with the percentage of votes cast favorable to management and with voting turnout in the full sample. This result indicates that owners of large blocks of shares act in concert with, or at least support, management. Not surprisingly, we find that insider ownership is positively associated with voting turnout and the percentage of votes cast favorable to management. However, institutional ownership is negatively associated with the percentage of votes cast favorable to management in both samples. This finding supports recent evidence of institutional activism, and Brickley et al. (1994) which finds that institutional shareholders vote against management, especially when investors perceive shareholder wealth is at stake.

VI. Discussion and Conclusions

In this study, we explore the balance of power between managers and shareholders in the proxy process, as delineated by firms' institutional and regulatory environment. In the sample, we find evidence suggesting that the institutional and regulatory environment may confer a vote-getting advantage to managers. On average, routine management proposals have higher voting turnout and receive more votes cast favorable to management than do non-routine proposals. The passage of as many as 73 routine proposals in 1998 may have been swung because they were classified as routine, rather than non-routine, proposals.

Not surprisingly, we find that firm ownership structure affects voting results. The percentage of votes cast favorable to management is increased by the presence of investors with large blocks of shares and insider holdings and is reduced by institutional investor holdings. ISS recommendations that are unfavorable to management are associated with fewer votes cast in favor of management, even after we control for dilution and other factors that capture institutions' voting guidelines.

This evidence is important, because it suggests that brokers' ability to vote uninstructed shares can dislocate voting and cash-flow rights. Certain features of the institutional and regulatory environment can alter voting results, perhaps even causing shareholders' voted preferences to be overridden. This finding may be important to securities regulators and other organizations as they review and pursue corporate governance reform. The findings also have implications for studies of ownership structure and corporate control that model voting power as one vote per share.

An implication of these findings is that managers are likely to have incentives to alter the control rights of shares by changing their firms' institutional and regulatory environment. For example, the NASD recently filed a proposal that would codify its brokers' right to vote beneficial owners' uninstructed shares on routine matters.¹¹ Given the results in this study, we might expect

¹¹See SEC Release No. 34-42238, File No. SR-ASD-99-63, Notice of Filing of Proposed Rule Change and Amendment No. 1 thereto by NASD to Allow NASD Members to Give Proxies in the Absence of Written Instructions from Beneficial Owners, 12/22/99.

that such a rule, if it changed brokers' behavior, would reduce the control rights of existing investors' shares and, therefore, would be supported by Nasdaq-listed firms.

Shareholders are also likely to have incentives to alter the control rights of shares through direct contact with firms and by lobbying to change regulatory policy. For example, shareholders have incentives to preclude managers from counting broker votes and abstentions in determining voting outcomes by submitting and passing shareholder proposals to that effect. Shareholders might also want to endorse regulatory and institutional changes to enhance the control rights of shares. For example, in 1992 shareholders supported changes to SEC rules that enhanced shareholder communication and coordination of proposal submissions to firms. More recently, the CII asked the NYSE to revise its rules so as to preclude brokers from voting uninstructed shares altogether. To the extent that shareholders are successful in lobbying for regulatory change, they are able to enhance the control rights of shares. ■

Appendix A. Non-Routine Matters

This appendix lists the 18 categories of proposals that the NYSE and Amex classify as non-routine matters on which brokers may not vote beneficial owners' uninstructed shares.

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- 1 Is not submitted to shareholders by means of a proxy statement comparable to that specified in Schedule 14-A of the SEC.
 - 2 Proxy contests.
 - 3 Mergers and consolidations.
 - 4 Shareholder appraisal rights.
 - 5 Authorizations of property mortgages.
 - 6 Authorizations or increased authorizations of company indebtedness.
 - 7 Authorizations or increased authorizations of classes of preferred stock.
 - 8 Alterations of the terms or conditions of existing stock or indebtedness.
 - 9 Modifications of preemptive rights.
 - 10 Changes to stockholder meeting quorum requirements.
 - 11 Alterations of voting provisions of stock.
 - 12 Authorizations or issuances of stock or stock options to directors, officers, or employees in amounts that exceed 5% of outstanding common shares.
 - 13 Authorizations or increased authorizations of profit sharing or special remuneration plans that exceed 10% of average annual income before taxes.
 - 14 Material changes in a company's lines of businesses.
 - 15 Acquisitions of property, assets or a company, where the fair market value exceeds 20% of the firm's market value.
 - 16 Sales of property or earning power approximating 20% or more of those existing before the transaction.
 - 17 Authorizations of transactions not in the ordinary course of business in which officers, directors, or substantial security holders have a direct or indirect interest.
 - 18 Reductions in earned surpluses of 51% or more, or reductions in earned surpluses by less than the aggregate of three years of common stock dividends.
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Appendix B. Data Items and Information Sources

| Data Item | Source | Notes |
|-------------------------------------------------|-----------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Votes Cast | Company 10-Ks, 10-Qs, and 8-Ks. | |
| Eligible Votes | Company Proxy Statements | |
| Proposal Passage Requirement | Company Proxy Statements | |
| Use of External Solicitor | Company Proxy Statements | |
| Solicitation Expense | Company Proxy Statements | "Solicitation Expense" is the SEC-required disclosure of fees paid to proxy solicitors, and does not include out-of-pocket expenses incurred by the company or their proxy solicitors. |
| Proposal Routine/ Non-Routine Classification | NYSE <i>Weekly Bulletin</i> | |
| ISS Voting Recommendation | ISS <i>Proxymaster</i> | |
| Proposal Dilution | IRRC (Moore and Tobey, 1997; Newbury, 1998: 1999), Company Proxy Statements, and 10-Ks. | "Proposal Dilution" is the additional votes that would have resulted had a proposal been adopted, divided by a firm's total number of eligible votes before proposal adoption. |
| Total Dilution | IRRC (Moore and Tobey, 1997; Newbury, 1998:1999), Company Proxy Statements, and 10-Ks. | "Total Dilution" is the additional votes that would have resulted had a proposal been adopted, plus shares reserved for stock option issuance, plus unexercised stock options outstanding under existing plans, divided by a firm's total number of eligible votes before proposal adoption. |
| Share Turnover | CRSP, Company Proxy Statements | "Share Turnover" is the total shares traded between a firm's record and meeting dates as a proportion of primary shares outstanding. |
| Share Ownership: | Compact Disclosure | Our definitions are based on SEC disclosure requirements for each category of shareholder. |
| Insider Ownership | | |
| Institutional Ownership | | |
| Blockholder Ownership | | |
| MV | Compustat | "MV" is equity market valuation. |
| M/B | Compustat | "M/B" is the ratio of the market value of a firm's equity to the net book value of its physical assets. |
| ROA | Compustat | "ROA" is a firm's earnings before interest, taxes, depreciation, and amortization divided by net assets. |
| 1-Yr. Mkt.-Adj. Perf. | Compustat | "1-Yr Mkt.-Adj. Perf." is a firm's one-year stock return net of the market's one-year return. |
| P/E | Compustat | "P/E" is a firm's price divided by earnings per share. |
| D/A | Compustat | "D/A" is a firm's debt-to-asset ratio. |

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